Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

October Term, 1995

H.W. TSENG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether § 152(b)(3) of the Internal Revenue Code, which defines a "dependent" to exclude any individual who is not a citizen or national of the United States, unless such individual is a resident of the United States or of a country contiguous to the United States, is consistent with the Equal Protection component of the Fifth Amendment.

LIST OF PARTIES

Pursuant to Supreme Court Rule 14.1(b), the Petitioner states that the caption of the case contains the names of all of the parties.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

H. W. Tseng respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINION BELOW

The opinion of the Court of Appeals (App., *infra*, App. 1 - App. 4) is an unpublished Memorandum Opinion, designated C.A. No. 94-70468. The opinion of the Tax Court (App., *infra*, App. 8 - App. 24) is a Memorandum Opinion and is reported as T.C. Memo. 1994-126.

JURISDICTION

The judgment of the Court of appeals was filed on March 13, 1996. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In addition to the Fifth and Fourteenth Amendments to the United States Constitution, this case involves the

Internal Revenue Code, (the "Code"), 26 U.S.C. § 152,[1] which, in its pertinent parts, states as follows:

> "(b)(3) The term 'dependent' does not include any individual who is not a citizen or national of the United States unless such individual is a resident of the United States or of a country contiguous to the United States." The full text of the section is set forth at App., *infra*, App. 63 - App. 65.

STATEMENT OF THE CASE

This case involves the refusal of the Internal Revenue Service ("Service") to allow a dependency exemption to the Petitioner on his Federal Income Tax Return Forms 1040 ("Return"), when he supplied more than half of the support to family members who qualify for such dependency exemptions because they did not live in the United States or a contiguous country during the years when the dependency exemption was claimed.

A. Support of Relatives

Dr. Tseng, the holder of a Doctor of Philosophy (majoring in electrical engineering) degree, is a naturalized United States citizen born in China. At the time of filing of his Returns for the years in question,[2] he resided

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[1] Unless otherwise stated, all citations are to the Internal Revenue Code in effect for the years in question.

[2] The Internal Revenue Service audited the Petitioner's Forms 1040 for calendar years 1985 and 1986 and it is those returns that are in question.

in San Luis Obispo, California. Dr. Tseng supported his mother, Mei-Yung Chou Tseng, in 1985 and 1986, and his nephew, Chin-Pong Tseng, in 1986, providing more than half of their support in each of those years.

During each of those years, Dr. Tseng's mother and nephew were citizens of the People's Republic of China. In each of those years they resided solely in China. The nephew was a student attending school in China.

On his Return for 1985, Dr. Tseng claimed a dependency exemption for his mother under Code §§ 151(a) and (c)(1). On his Return of 1986, Dr. Tseng claimed dependency exemptions for both his mother and his nephew.

B. Internal Revenue Service Audits

The Service chose Dr. Tseng's 1985 and 1986 Returns for audit. During the course of the audit, nine (9) issues were questioned by the Service.[3] After negotiations with Dr. Tseng, the Service determined deficiencies in Dr. Tseng's 1985 and 1986 income taxes in the amounts of $7,529.49 and $6,185.11, respectively.

C. Proceedings in the Tax Court

In response to the Service's March 2, 1992 Notice of Deficiency, Dr. Tseng filed a timely petition with the United States Tax Court. On May 12, 1993 a trial of the issues was held before Special Trial Judge Larry L. Nameroff, sitting in

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[3] This appeal only deals with one of those items, the allowance of dependency exemptions.

Los Angeles, California. Some of the facts were stipulated and so found by the Tax Court.[4]

On March 28, 1994, the Tax Court issued its opinion in this case. (App., *infra*, App. 8 - App. 24). On April 29, 1994, the Tax Court entered its decision. (App., *infra*, App. 7). No motion or petition for rehearing was filed.

D. Proceedings in Court of Appeals

On July 27, 1994, Dr. Tseng filed a timely Notice of Appeal with the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit"). The Ninth Circuit ordered that the case be submitted without oral argument (App., *infra*, App. 5) on March 5, 1996. On March 13, 1996, the Ninth Circuit filed its Memorandum Decision. (App., *infra*, App. 1 - App. 4). The Ninth Circuit held, *inter alia*, that Dr. Tseng was not allowed a dependency exemption for either his mother or his nephew because they were not residents of the United States or a contiguous country in the years in question. The Ninth Circuit rejected Dr. Tseng's argument that technological and political changes and current economic circumstances were such that the continued application of the "contiguous country" restriction in § 152(b)(3) no longer bore a rational relationship to a legitimate governmental purpose.

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[4] One of the facts that was stipulated was that Dr. Tseng did, in fact, provide more than half of the support to his mother and nephew, in the years in question.

REASONS FOR GRANTING THE PETITION

This is a case of great importance to a significant number of naturalized citizens and permanent residents of the United States. In its decision, the Ninth Circuit sustained a portion of the Internal Revenue Code that deprives not only Dr. Tseng but the public at large from claiming a dependency exemption when they meet all of the requirements for such an exemption, except for the residency requirement. The residency requirement became a part of the definition of a dependent in 1944,[5] a time when the United States Congress was dealing with an isolationist mentality brought about by the involvement of the United States in World War II. No reason for the inclusion of this residency requirement was ever disclosed by the sponsors of the law. In the only mention before the House and Senate presentation and discussion of the 1944 Act, prior to its passage, the propriety of including that requirement was questioned by one of the Senators.

All of the courts which have reviewed this provision have held that it was placed in the Code as an administrative aid and that that purpose continues today. When all of the applicable Committee Reports and Committee and Congressional discussions on the bill are reviewed, there is no support for that position. The Ninth Circuit in this case and the courts in other cases reviewing the same issue based their decisions on a faulty premise.

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[5] The new residency requirement was included in the Individual Income Tax Act of 1944, P.L. No. 315 (the "1944 Act").

This case also has important constitutional issues that need to be decided. When the Ninth Circuit sustained the constitutionality of § 152(b)(3), they did so in violation of the guidelines set down by this Court for reviewing constitutional challenges to revenue statutes. The Ninth Circuit's decision in this case, if sustained, would be the death knell of any further challenges to the constitutionality of § 152(b)(3), a section that this Court should find unconstitutional, as more fully set forth in the argument below.

In its decision in *Dumdeang v. Commissioner*, 739 F.2d 452 (9th Cir. 1984), a case that reviewed the same question, the court said:

> "Future litigants are forewarned that it is likely that double costs will be awarded against taxpayers who appeal this issue. See *Edward v. CIR*, 680 F.2d 1268, 1271 (9th Cir. 1982)"

Because of his conviction in the correctness of the position that he should be allowed a dependency exemption for his mother and nephew, Dr. Tseng appealed this decision, even in face of these potential penalties. Should this Court refuse this Petition for Writ of Certiorari, future appeals to test not only the correctness of this most important issue but the correctness of the method of review by the Courts of Appeals will probably not be forthcoming.

This case also has important issues that deal with the proper method for a federal court to review federal statutes. Without a pronouncement from this Court, other courts will continue to make decisions that a federal statute is constitutional because it is based on a rational

relationship to a legitimate governmental purpose, without inquiring into the real reason for the statute and whether it continues to serve any governmental purpose, let alone an important one. Courts, in interpreting federal statutory provisions should not be guided by unfounded pronouncements of other courts, such as the courts did here in following *Gitter v. CIR*, 15 T.C. 520 (1949)[6] and its progeny.

Finally, this Petition for Writ of Certiorari should be granted because the decision of the Ninth Circuit was erroneous, based on a review of all of the facts and circumstances surrounding this matter.

A. SECTION 152(b)(3) VIOLATES THE IMPLIED EQUAL PROTECTION COMPONENT OF THE FIFTH AMENDMENT BY DISCRIMINATING AGAINST TAXPAYERS WHOSE RELATIVES DO NOT LIVE IN THE UNITED STATES OR A CONTIGUOUS COUNTRY.

1. The Fifth Amendment Protects Citizens Against Discrimination by the Federal Government Based on National Origin.

Although the Fifth Amendment to the United States Constitution does not specifically contain the magical words "Equal Protection," as does the Fourteenth Amendment, it has been interpreted to contain an Equal Protection component. *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975); *Bolling v. Sharpe*, 347 U.S. 497, 199

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[6] This is the first case to review the propriety of requiring a dependent to live in the United States or a contiguous country in order for a dependency exemption to be allowed.

(1954). The Fifth Amendment prohibits discrimination that is "so unjustifiable as to be violative of due process." *Bolling*, at 499. The Equal Protection analysis is the same under the Fifth and Fourteenth Amendments. *Weinberger*, at 638 n.2. The only difference between the two amendments is the identity of the potential discriminator.

2. Discrimination Based on National Origin, a Suspect Class, Is Reviewed under the Strict Scrutiny Standard.

In the infamous case of *Korematsu v. United States*, 323 U.S. 214, 216 (1944),[7] this Court first coined the phrase "suspect class." Classifications based on race are suspect and to be reviewed using the most rigid scrutiny. *Id.* Since 1944, the United States has formally apologized for its unjustified internment of American citizens during World War II and *Korematsu* would not likely be decided the same today.[8] The rule of Strict Scrutiny has withstood the test of time.

To survive a challenge under strict scrutiny, a statute must be necessary to further a compelling governmental purpose and there must be no less restrictive means available to further that interest. *Palmore v. Sidoti*, 466 U.S. 429, 432-33 (1984). Strict scrutiny is required because race is seldom relevant to the achievement of any compelling,

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[7] It should be noted that this is the very same year when the residency requirement for a dependency exemption became a part of the predecessor to § 152(b)(3).

[8] In the same vein, the Petitioner submits that if the residency requirement was being considered today, it is his belief that it would not become a part of the Code.

or even legitimate, governmental purpose. *City of Cleburne, Texas v. Cleburen Living Center, Inc.*, 473 U.S. 432, 440 (1985). National origin is the first cousin of race and, like race, discrimination based on ethnicity should be reviewed under strict scrutiny. *Karcher v. Daggett*, 462 U.S. 725, 758 (1983).

3. Dr. Tseng and Similarly Situated Taxpayers Were Discriminated Against by the Service's Enforcement of § 152(b)(3).

In this matter, Dr. Tseng is a member of a suspect class. Dr. Tseng is an American citizen of Chinese ancestry. All other taxpayers who are naturalized citizens, except those originally from Mexico and Canada, are also of a suspect class. Dr. Tseng's ancestry should not be a determinative factor of the rights to which he is entitled as a United States citizen. The basic edict of Equal Protection is that all persons similarly situated be treated alike. *City of Cleburne*, at 439. "Taxes should be . . . equally collected from all taxpayers . . . who are similarly situated." *Stacy v. United States*, 231 F. Supp. 304, 307 (S.D. Miss. 1963).

As a naturalized citizen, Dr. Tseng, is similarly situated to every other taxpayer who is a naturalized citizen, including naturalized citizens who emigrated to the United States from Mexico and Canada. In its application to all naturalized citizens, § 152(b)(3) does not treat them similarly. Naturalized citizens from Canada and Mexico are allowed to claim dependency exemptions for any relatives for whom they provide more that half of their support, even though they are not living in the United

States.[9] According to the Service, as supported by the decision in this case and its predecessors, all other naturalized citizens, other than those in Canada and Mexico, cannot claim a dependency exemption for any relative for whom they provide more than half of their support, except when they are living in the United States, Canada or Mexico.

This disparity in treatment of naturalized citizens, Dr. Tseng included, is a clear violation of the principle enunciated in *Stacy*, that all similarly situated taxpayers must be similarly treated. The Service cannot assert any legitimate reasons to justify discriminating against naturalized citizen taxpayers, based on their national origin. There is no compelling, nor even legitimate, governmental interest that is served by allowing a naturalized Mexican-American or Canadian-American citizen to claim a dependency exemption for relatives while denying a similar dependency exemption to a naturalized American citizen of any other country.

B. IN THE ALTERNATIVE, § 152(b)(3) IS UNCONSTITUTIONAL BECAUSE IT DOES NOT EVEN PASS THE RATIONAL RELATIONSHIP TEST.

If this Court determines that the Strict Scrutiny Standard of review does not apply to this case, the reasonable relationship test applies.

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[9] Relatives living in Guam, the Canal Zone, the Republic of Panama, American Samoa, or, in some circumstances, the Phillippines are also given this special treatment.

1. Economic Legislation Is Reviewed Using the Rationally Related Test.

Economic and social welfare legislation is reviewed under the "rationally related" standard of review. *Sullivan v. Stroop*, 496 U.S. 478, 485 (1990); *City of Dallas v. Stranglin*, 490 U.S. 19, 28 (1989). "Normally, a legislative classification will not be set aside if any state of facts rationally justifying it is demonstrated to or perceived by the courts." *United States v. Maryland Savings-Share Ins. Corp.*, 400 U.S. 4, 6 (1970). The Service may not rely on a classification that is so attenuated to the stated goal that the classification is arbitrary or irrational. *City of Cleburne*, at 466.

In the context of state property taxes, it was held that taxes may be different on different classes of property, so long as the class divisions and tax burdens are reasonable. *Allegheny Pittsburg Coal Co. v. County Commissioner of Webster County, West Virginia*, 488 U.S. 336, 344 (1988). The court in *Allegheny* states that taxes will be upheld provided they are neither "capricious nor arbitrary." *Id.* If there is some reasonable basis for the classifications and taxes, then there is no denial of Equal Protection. *Id.* The same reasoning should apply to federal income taxes. The important thing to note is that, unlike *Allegheny*, Dr. Tseng was in the **same** class as all other naturalized citizens, yet, because he did not originate from Canada or Mexico, he is treated differently from those naturalized citizens who did originate from Canada or Mexico.

2. Section 152(b)(3) Is Not Rationally Related to Any Legitimate Governmental Purpose.

This Court will overturn a statute where the varying treatment of groups is "so unrelated to the achievement of any combination of legitimate purposes that we can only conclude that the legislature's action was irrational." *Vance v. Bradley*, 440 U.S. 93, 97 (1979). The disparate treatment of all naturalized citizens, other than those from Canada and Mexico, should be stricken as violative of Equal Protection.

3. There Is No Legislative History Which Supports the Service's Argument That the Restrictions in § 152(b)(3) Are Mandated by Administrative Requirements.

The Service's argument that there is a legitimate need to limit the § 151 dependency exemption to those who satisfy the requirements of § 152(b)(3), *i.e.*, taxpayers whose dependents are residents of contiguous countries, is significantly flawed when scrutinized closely. Because of the Service's position, the various courts that have reviewed this section have blindly followed the Service's lead, including the Ninth Circuit in deciding Dr. Tseng's appeal.

Prior to 1944, in order for a dependency exemption to be allowed, the dependent must have been under the age of 18 or physically or mentally incapable of self-support, and for whom the taxpayer furnished the chief support. House of Representatives Report No. 1365, Seventy-eighth Congress, Second Session, on H.R. 4646, p. 841.

This method for the allowance of a dependency exemption was replaced by a three factor test. *Id.*

The dependent would first have to meet a support test. The taxpayer claiming the dependency exemption had to provide over half of the dependent's support. Next the dependent must meet a relationship test. The dependent must be of a specified relationship. Essentially, the dependent had to be a member of the taxpayer's immediate family. Individual Income Tax Provisions of the Internal Revenue Code Applicable to Taxable Years Beginning in 1944 or Later, as compiled for the use of The Joint Committee On Internal Revenue Taxation by its Staff, § 25(b)(3), p. 27. The residency test required that, if the dependent was not an American citizen, they must live in the United States or a contiguous country. *Id.* p. 28.

There were no public hearings on this bill. 1944 Congressional Record, pp. 3969, 3970. The purpose for this addition of the residency requirement must be gleaned by an examination of the published Committee Reports and the colloquy reported in the Congressional Record. Counsel for Dr. Tseng has personally reviewed all published Committee Reports and all colloquy in the 1944 Congressional Record when the bill was introduced and discussed in both the House of Representatives and in the Senate.

The new residency requirement is very seldom mentioned. Even when the Committee Report or colloquy specifically referred to the new definition for the allowance of dependents, with one exception, it is merely stated as a matter of fact.

The only comment, other than a mere recitation of the new rule, is made by Senator Langer of North Dakota when, while explaining the provisions of the bill to the Senate, he states:

" . . . here it reads:

> Credits against net income: In the case of a nonresident alien individual who is not a resident of a contiguous country –

Let me read that again:

> Credits against net income: In the case of a nonresident alien individual who is not a resident of a contiguous country –

So this would not apply to Mexico or Canada – . . .

> Mr. President, perhaps that is very plain to some folks, but I fail to understand why there should be a distinction between the case of a nonresident alien individual who is a resident of a contiguous country, such as Mexico, and a man who is living in Venezuela. **Why should they not be treated alike.**" 1944 Congressional Record p. 4716. (Emphasis Added)

Why, indeed! Does this sound like a Senator who thinks this provision should become a part of the law to ease the administrative burdens of the Service? It doesn't seem so.

Another comment in the Congressional Record is helpful in understanding that the Congress did not allow the contiguous country requirement to become a part of the law as a way of easing the administrative burden of the Service. Representative Curtis of Nebraska said:

> "The administration spokesmen . . . shouted 'administrative difficulties' without being specific. Do the Bureau of Internal Revenue and the Treasury Department exist to serve the taxpayers or do the taxpayers exist to serve these bureaus." 1944 Congressional Record, p. 4029.

Again, Congress was challenging the claim of administrative difficulties that would result from the passage of the bill.

Neither Senator Langer nor Representative Curtis' comments were ever challenged by any of the other members of Congress. None of them even commented on their statements. How then can the Service claim, and the courts find, that the reason the contiguous country requirement of § 152(b)(3) was placed in the law was a result of the need for administrative convenience or to aid the Service in the verification of information.

Why then was it included in the bill? Congress was perhaps driven by a war-time mentality. Perhaps they were suffering from an isolationist mentality when the bill was drawn. Maybe it was included because of some hidden agenda of a member of Congress.[10] We do not know, nor does the Service or the courts. As noted, there is nothing in any of the Committee Reports or colloquy recorded in the 1944 Congressional Record that provides the reason why it was included.

If we cannot identify why the provision was put in the law, how can the legitimate governmental purpose that it serves be examined? The inclusion of this provision

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[10] See the discussion of Gitter on beginning on page 17 for a possible explanation.

must, as *Vance* and *City of Cleburne* suggest, be irrational. As such it cannot satisfy the rational relationship test.

4. The Courts, Including the Ninth Circuit, Had No Basis for Their Decisions in the Various Cases Examining the Contiguous Country Requirement for a Dependency Exemption.

The theory that § 152(b)(3) was based on administrative need did not come from Congress. It evolved sometime between 1944 and 1949 when *Gitter v. Commissioner,* 13 T.C. 520 was decided. Subsequent to Gitter, and its progeny *Barr v. Commissioner,* 51 T.C. 693 (1969), the courts relied on this reasoning in *Wexler v. Commissioner,* 33 T.C. Memo 1974-113, aff'd 507 F.2d 843 (6th Cir. 1974), *Habeeb v. Commissioner,* 739 F.2d 435 (5th Cir. 1977, *Hsu v. Commissioner,* T.C. Memo 1982-47, *Dumdeang v. Commissioner,* 739 F.2d 452 (9th Cir. 1984), and the Ninth Circuit's decision in Dr. Tseng's case, without ever questioning the basis for the original decision in *Gitter.*

The court in *Gitter* states:

> "Congressional purpose regarding the phrase 'citizen or subject of a foreign country' is clearly revealed in H. Report No. 1365, 78th Cong. 2nd sess., on the Individual Income Tax bill of 1944 (1944 C.B. 821, 841) wherein it said in part:
>
> . . . the new system of exemptions grants a surtax exemption for every person closely related to the taxpayer in any of several specified degrees of relationship for whom the taxpayer provides over half the support. In addition, it is provided that the term 'dependent' does not include any nonresident alien

> individual unless such individual is a resident of a country contiguous to the United States."

This is not a statement of a Congressional purpose. It is a mere recitation of what the law is. Nothing in that quote, or as noted more fully above, nothing in the Committee Reports or the colloquy in the 1944 Congressional Record supports the conclusion of the court in *Gitter* that this was put in the law for administrative ease. Because of this false premise of the court in *Gitter*, all of the other cases that follow are also based on a false premise.

Although the court in *Gitter* gives lip service to the administrative difficulties of verifying dependency exemption, the court itself suggests that the real reason for the enactment of the residency requirement was anything but administrative difficulties, when it stated:

> "What caused this change in the criterion of a dependent? Since the commencement of World War II there has been a great increase in the number of taxpayers claiming dependency credits for Europeans whom they were helping to support. A spectacular example of this trend was the case of *Astley v. Rogan*, U. S. Dist. Ct., So. Dist. Calif, Central Div., June 18, 1943, Memorandum Opinion and Order No. 1662-B, wherein the taxpayer successfully claimed dependency credits for 51 French children. . . . Congress meant to exclude all nonresident aliens, citizens or not citizens, from the status of dependents unless they reside in North America, when it used the phrase 'citizen or subject of a foreign country' residing outside the United States or a country contiguous thereto."

This type of discrimination is exactly the type of governmental action that this Court has previously found to be unconstitutional.

In *Barr,* the court said:

> "[I]n 1944, Congress became convinced that dependency deductions were being claimed in questionable situations. It was impracticable for the Internal Revenue Service to investigate all these claims. . . . It would be impossible for the Internal Revenue Service to ascertain the total support of children . . . living in a country with which our relationship was not amicable. . . . [I]t would be impracticable for the Internal Revenue Service to confirm the validity of the claimed support."

The cases subsequent to *Barr* cite *Barr* to support their position that there is a legitimate governmental purpose for the contiguous country provision. (*Wexler,* "Congress enacted . . . 152(b)(3) to facilitate the administration of the law . . . ," citing *Barr; Habeeb,* "Congress could . . . recognize the administrative necessities of effective oversight and attainable administration." citing *Wexler; Hsu,* "[T]he limitations were imposed for practical reasons to facilitate the administration of the income tax law," citing *Barr; Dumdeang,* "The overall purpose of § 152(b)(3) is to facilitate administration of the dependency exemption provisions . . . especially where the IRS . . . is thwarted by the existence of hostile relations between the United States and countries where claimed dependents may reside," citing *Barr;* and *Tseng* (9th Cir. App. 2) "[T]he statute (152(b)(3)) facilitates the IRS' ability to verify dependency exemptions," citing *Dumdeang.*)

This language hardly supports the lessening of administrative difficulties as a legitimate governmental purpose. It is more focused on the difficulty of verifying information. It should also be remembered that in Dr. Tseng's case, the Service has conceded that Dr. Tseng provided over half of the support for his mother and nephew in the years in which he claimed them as a dependent. As a result, isn't the allowance of a dependency exemption to him specifically authorized by the language of these cases, because there is no administrative problem in verifying whether he supplied the appropriate level of support?

None of these cases delve into the real reason for the enactment of the predecessor of § 152(b)(3). In 1996, it would be pure speculation to say where, and why, this theory originated and require this Court to look into a crystal ball for guidance.

There is no rational relation between the disallowance of the dependency exemption to naturalized citizens from countries other than Mexico and Canada to a legitimate governmental purpose.

C. THE PREMISE BEHIND THE ORIGINAL ENACTMENT OF § 152(b)(3) AND THE CASES SUPPORTING IT IS NO LONGER VALID.

Even if one were to concede that when § 152(b)(3) was enacted and when all the cases before *Tseng* were decided, it

was rationally related to a legitimate governmental purpose,[11] that rational relationship no longer exists.

1. Changes in Technology Have Been So Great That the Service Has No Difficulty in Verifying the Dependency Exemption.

When § 152(b)(3) was initially enacted, the United States was embroiled in World War II. When *Gitter* and all of the decisions in the other cases, prior to *Tseng*, were made, the Cold War existed. The Berlin Wall was up. The Bamboo, Iron and Silk Curtains existed. Travel to many countries, China included, was restricted.

That situation no longer exists. The Cold War has ended. The Berlin Wall and the Bamboo, Iron and Silk curtains have fallen. Americans can travel freely in China, as they can in most other countries. Mc Donald's and Kentucky Fried Chicken[12] have opened stores in China. The United States now has diplomatic relations with all but a handful of countries. The upcoming Summer Olympics will have representatives participating from every single country in the world.[13] The Service cannot constitutionally remain in a bygone era.

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[11] In Dumdeang the court makes the following statement: "the Dumdeang's apparently conceded that in 1944 § 152(b)(3) was rationally related to the legitimate government objective of providing verification for claimed dependency exemptions." at 454.

[12] And probably many other fast food purveyors.

[13] This is the first time in history that every single country in the world, without exception, has sent athletes to the modern Olympic games.

In 1978, the United States formally recognized the People's Republic of China as a nation. Recently the United States extended "Most Favored Nation" status to China. The United States has an active embassy in Beijing and a number of diplomatic posts and economic missions throughout the country.

Both the United States and China, as well as most of the rest of the world, are part of a global economy with full access to the "information super-highway." China, as are most nations, is easily accessible by direct dial telephone, Fax and the Internet. While "surfing the Net" one can find information on educational and professional opportunities in China. It is no more difficult for the average Internet user to secure information for, about and from China than it is to secure information for, about and from Mexico. In some situations it is even easier.

The courts should be required to not just blindly follow decisions of older cases, but to monitor the changes in technology and world circumstances before they make decisions about administrative difficulties, especially when such an inquiry can make it clear that these administrative difficulties no longer exist. The Ninth Circuit in *Tseng* summarily rejected this inquiry, when it said:

> "Tseng cannot deny, however, that non-contiguous investigation generally poses significantly greater administrative burdens on the IRS than contiguous investigations." (App., *infra*, at App. 2).

Dr. Tseng does, indeed, deny that it is adminstratively more difficult.

Verification of a claimed dependent's existence, relationship and level of support is no more difficult in China than in Mexico or Canada. It would be no more difficult or time consuming for a Service Revenue Agent who speaks Chinese to make a direct dial, or Internet, call to China and secure information about an individual than it would be for a Service Revenue Agent who speaks Spanish to make a direct dial, or Internet, call to Mexico and secure information about an individual. Each country has their own "Country Code"[14] and can be called by direct dialing.

Even if one were to concede that there once was a rational basis for the provisions of § 152(b)(3), under the current technology, political and economic circumstances, that basis no longer exists.

2. The United States-China Tax Treaty Allows for the Acquisition of All Necessary Information.

In April of 1984, the United States and China entered into an Income Tax Treaty. (App., *infra*, App. 32 - App. 37, in its pertinent parts) The treaty specifically applies to income taxes. § 1(b) of Article 2.

Section 1 of Article 25 provides, in part, that "[T]he Contracting States shall exchange such information as is necessary for carrying out . . . the domestic laws of the

[14] 86 for China and 52 for Mexico. As an indication of the progress that has been made, when counsel for the Petitioner called long distance information to secure these country codes, the operator did not have to look either one of them up. They were instantly supplied from the operator's memory.

Contracting State . . . (such information) shall be disclosed . . . to authorities involved in the assessment . . . of taxes covered by this Agreement." Even without the advances in technology, which certainly cannot be ignored, the Service has a ready method for gathering any information it needs to consider in allowing a dependency exemption. By Treaty, China would provide all appropriate information needed to verify the dependency exemption, once requested by the Service.

On July 30, 1985 Assistant Treasury Secretary, Ronald A. Pearlman, testified before the Senate Foreign Relations Committee on, among others, this tax Treaty with China. During the course of his prepared remarks, he stated:

> "An equally important feature of tax treaties is that they provide for cooperation between the tax authorities of the two countries. The competent authorities may exchange such information, including taxpayer information, as may be necessary for the proper administration of the countries' tax laws. . . . Tax administrators also benefit from tax treaties. The principal benefit is through the exchange of information provisions found in all tax treaties.[15] . . . **The Internal Revenue service receives information from our treaty partners, generally on a routine basis** . . . In addition, **information can be requested from our partners relating to specific taxpayers** and transactions." 85 Tax Notes International 26-5. (Emphasis added)

Here is the Assistant Treasury Secretary, one of the highest ranking members of the Treasury Department, the

[15] A similar provision exists in the Treaty with Mexico.

parent administrative Department of the Service, indica
ing that securing the information to verify dependen
exemptions is quite simple, at least in those countri
where a tax treaty exists. This hardly sounds like stro
support for the position taken by the Ninth Circuit
Tseng or the Service in their position.

As another illustration of the effectiveness of the t
treaty in the exchange of information, Wang Wanliu of t
China International Tax Consultancy Company in Beiji
indicated that since 1989 the Chinese tax authorities ha
communicated successfully with the United States a
other countries to secure information regarding taxpaye
in China who were suspected of reporting false incom
As a result of this exchange of information, China's t
authorities have determined that foreigners evaded inc
vidual income taxes in China amounting to US $20 m
lion. 95 Tax News International 145-4, July 28, 1995.

If the Chinese taxing authorities can be so successf
using the tax treaty, it should be an affront to the Servi
to suggest that they cannot use the very same tax trea
to verify the propriety of dependency exemptions
China, or in any other nation where there is a tax treat
Discriminatory statutes that are simply based on admini
trative convenience, as § 152(b)(3) seems to be, are unco
stitutional. *Reed v. Reed*, 404 U.S. 71, 76 (1971).

Section 152(b)(3) is impermissibly over-inclusive,
prevents taxpayers from using a dependency exemptio
for dependents that live in countries where the Servi
cannot reasonably be expected to verify their existence

income such as Cuba and Iraq, but it also encompasses dependents living in countries such as Switzerland, England, Japan and China where information is readily available.

This is a discrimination between taxpayers that this Court has consistently found to be unconstitutional.

D. SECTION 152(b)(3) IS CONTRARY TO PUBLIC POLICY.

Dr. Tseng has a moral and ethical obligation to support his aging mother. In California, this duty has been codified in the California Family Code at § 4400, *et seq.* Family Code § 4400 places a mandatory duty on a child to support his or her parents, to the extent to which they are able. The section provides that a child **shall** provide such support. California emphasizes the affirmative nature of the obligation by making the failure to provide for an indigent parent a misdemeanor, a criminal charge. California Penal Code § 270c.

The obligation to support one's parents has no geographic boundary. California Family Code § 3550 states that the duty imposed by § 4400 is binding upon all California residents (obligors) regardless of the residence of the parent (obligee).

Dr. Tseng's mother has a legal right to emigrate to the United States. She had not done so because she was over ninety years old and, unfortunately, in ill health. She could only stay in China because of Dr. Tseng's support. He should not be penalized by the Service for abiding by his moral and legal duty to support his mother, just

because she is not living in the United States, Mexico or Canada. On the contrary, allowing Dr. Tseng a dependency exemption for supporting his mother in China results in a lesser economic burden in the United States and is the most cost effective way to provide for her support.

The alternative would have been for Dr. Tseng to bring his mother to the United States where her care would be significantly more costly. The costs of living and medical care are substantially higher in the United States than in most countries, especially China. In restricting the dependency exemption to United States, Mexican and Canadian residents, the Service and Congress are in effect forcing all naturalized citizens from countries other than Canada or Mexico to bring their parents to the United States to, in some cases, be supported by United States Taxpayers, before they can claim a dependency exemption. This ultimately would create a greater burden on governmental funds than might be lost by allowing the dependency exemption to all citizens who support family members, no matter where they live.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

H. W. TSENG, Petitioner-Appellant, v. COMMISSIONER INTERNAL REVENUE SERVICE, Respondent-Appellee.	C.A. NO. 94-70468 Tax Ct. No. 11952-92 MEMORANDUM* (Filed Mar. 13, 1996)

Appeal from a Decision of the
United States Tax Court

Submitted, March 5, 1996**
Pasadena, California

Before: BROWNING, WALLACE, and FARRIS, Circuit Judges

H.W. Tseng appeals the Tax Court's decision upholding the Commissioner of Internal Revenue's determination of income tax deficiencies. We affirm.

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit as provided by 9th Cir. R. 36-3.

** The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); 9th Cir. R. 34-4.

I.

Section 152(b)(3) of the Internal Revenue Code prohibits Tseng from claiming dependency exemptions for his nephew and mother, both of whom were citizens and residents of China. Tseng challenges section 152(b)(3) on equal protection grounds.

We rejected an identical challenge in *Dumdeang v. Commissioner*, 739 F.2d 452, 454 (9th Cir. 1984). Other circuits have done the same. *See Habeeb v. Commissioner*, 559 F.2d 435, 437-38 (5th Cir. 1977); *Wexler v. Commissioner*, 507 F.2d 843 (6th Cir. 1974). In *Dumdeang*, we held that section 152(b)(3) makes distinctions based on geography, not race or national origin. 739 F.2d at 454. Further, we noted that the statute serves a legitimate administrative purpose. By limiting exemptions to dependents in the United States or contiguous countries, the statute facilitates the IRS' ability to verify dependency exemptions. *Id.*

Tseng argues that technological and political changes now make investigation in non-contiguous countries "practicable." Tseng cannot deny, however, that non-contiguous investigation generally poses significantly greater administrative burdens on the IRS than contiguous investigation. Section 152(b)(3) still furthers the legitimate governmental need to avoid excessive administrative costs. We reject Tseng's equal protection challenge.

II.

The Tax Court held that Tseng's living expenses in Minnesota were not deductible under 26 U.S.C. § 162(a)

(2) because they were not incurred "away from home." This holding was based on the court's finding that Tseng's employment at the University of Minnesota at Duluth was indefinite, not temporary. We review this finding for clear error. *See Neal v. Commissioner*, 681 F.2d 1157, 1158 (9th Cir. 1982).

Tseng maintains that his employment in Minnesota was temporary because he only intended to stay for one year. Based on the record, however, we conclude that the Tax Court was not clearly erroneous in determining that Tseng intended his employment in Minnesota to last at least 26 months. Further, the record shows that Tseng actually remained at the University of Minnesota for 43 months. The tax court did not clearly err in finding his employment not temporary. Rev. Rul. 83-82, 1983-1, C.B. 45, 46 ("[a]n expected *or actual stay* of 2 years or longer will be considered an indefinite stay, and not a stay away from home, *regardless of any other facts or circumstances*") (emphasis added)[1] We affirm the Tax Court's ruling that Tseng's living expenses were not business expenses under Section 162(a).

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[1] "While Revenue Rulings do not control our decision, they nonetheless provide guidance as they represent the considered opinion of the agency enforcing the tax laws." *Idaho Ambucare Center, Inc. v. United States*, 57 F.3d 752, 756 (9th Cir. 1995) (quotation omitted); *see also* 1995-1 C.B. iii (although Revenue Rulings "do not have the force and effect of Treasury Department Regulations . . . they may be used as precedents").

III.

Tseng's additional challenges to the Tax Court's decision are meritless. The record substantiates the court's finding that Tseng purchased two computers for personal, rather than professional, research. The computers were not depreciable. *See* 26 U.S.C. § 167(a). Tseng was not entitled to an investment tax credit under 26 U.S.C. § 48(a)(1).

Finally, the Tax Court properly concluded that it lacked jurisdiction to consider whether Tseng made an overpayment of his 1984 taxes. Tseng only challenged the Commissioner's determination of deficiencies for taxable years 1985 and 1986. The Tax Court's jurisdiction was limited to those years. *See* U.S.C. § 6214(b).

AFFIRMED.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

H. W. TSENG, Petitioner-Appellant, v. COMMISSIONER INTERNAL REVENUE SERVICE, Respondent-Appellee.	C.A. NO. 94-70468 Tax Ct. No. 11952-92 **ORDER** (Filed Feb. 27, 1996)

The Court has determined that the facts and legal arguments are adequately presented in the briefs and record and the decisional process would not be significantly aided by oral argument. Accordingly, this case is ordered submitted without oral argument on March 5, 1996, in Pasadena, California. Fed. R. App. P. 34(a); 9th Cir. R. 34-4.

FOR THE COURT

CATHY A. CATTERSON
CLERK OF COURT

By /s/ Gwen Baptiste
Deputy Clerk

UNITED STATES TAX COURT

Washington, D.C.

CERTIFICATE

I, CHARLES S. CASAZZA, Clerk of the United States Tax Court, do hereby certify that the document(s), attached hereto ~~is~~ are ~~a true copy~~ true copies of DOCKET ENTRIES, DECISION entered April 29, 1994 and MEMORANDUM OPINION (T. C. Memo. 1994-126) filed March 28, 1994

~~filed~~ in the case of H. W. TSENG, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 11952-92 in this Court, and that the original documents in that case are in my official custody and are on file in my Office.

IN TESTIMONY WHEREOF, my signature and the seal of the Court are affixed hereto at Washington, D.C., this 13th day of October, 1994.

CHARLES S. CASAZZA
Clerk of the Court

UNITED STATES TAX COURT
Los Angeles, CA 90012

H.W. TSENG, Petitioner,	)	
v.	)	Docket No. 11952-92
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the determination of the Court, as set forth in Memorandum Opinion 1994-126, filed March 28, 1994, at Los Angeles, California, it is

ORDERED AND DECIDED: That there are deficiencies in income taxes due from petitioner for the taxable years 1985 and 1986 in the amounts of $7,529.49 and $6,185.11, respectively.

/s/ Honorable Larry L. Nameroff
Special Trial Judge

Entered: APR 29 1994

T.C. Memo. 1994-126

UNITED STATES TAX COURT

H.W. TSENG, Petitioner *v.*
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 11952-92. Filed March 28, 1994

H.W. Tseng, pro se.

Sherri Munnerlyn, for respondent.

MEMORANDUM OPINION

NAMEROFF, *Special Trial Judge:* This case was heard pursuant to the provisions of section 7443A(b)(3) and Rules 180, 181, and 182.[1] Respondent determined deficiencies in petitioner's 1985 and 1986 Federal income taxes in the respective amounts of $7,529.49 and $6,185.11.

The issues for decision are: (1) Whether petitioner is entitled to deductions under section 162(a) for expenses incurred while "away from home"; (2) whether petitioner is entitled to deductions for claimed alimony payments for 1985 and 1986 in the respective amounts of $9,126.20 and $11,518.60; (3) if we determine that petitioner is entitled to deductions for alimony payments, we must then determine whether petitioner is entitled to deductions for home mortgage interest for 1985 and 1986; (4) whether petitioner is entitled to dependency exemptions for his mother, Mei-Yung Chou Tseng, for 1985 and 1986, and his nephew, Chin-Pong Tseng, for 1986; (5) whether

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

petitioner is entitled to head of household status for 1985; (6) whether petitioner is entitled to the general business credit claimed on his 1985 return; (7) whether petitioner is entitled to the net operating loss carryforward claimed on his 1985 return; (8) whether petitioner is entitled to exclude as community property 50-percent of the earnings received from California Polytechnic State University in 1985 but earned in a previous year; and (9) whether petitioner has established that he should be given a credit against his 1985 tax liability due to respondent's levies.

Some of the facts have been stipulated and are so found. At the time of the filing of the petition herein, petitioner resided in San Luis Obispo, California. Petitioner bears the burden of proving respondent's determinations are erroneous. Rule 142(a); *Welch v. Helvering*, 290 U.S. 111 (1933).

Away from Home Expenses

Petitioner was employed at California Polytechnic State University (Cal Poly) as a professor from 1969 until June 1984. In 1983, petitioner requested sabbatical leave from Cal Poly; however, such request was denied for budgeting reasons. Thereafter, petitioner applied for a position at the University of Minnesota at Duluth (UMD); UMD was establishing a computer engineering department and was searching for a department head.

On January 31, 1984, after interviewing with UMD, petitioner was offered the position of department head. The offer from UMD stated, in pertinent part:

> To follow up our phone conversation it gives me great pleasure to confirm that I am prepared to forward your name to the Regents of the University of Minnesota for the position of Professor and Head, Department of Computer Engineering at a nine-months' salary of $44,000 plus $2,000 department head augmentation. In addition, I will guarantee two months summer salary during 1984, 1985, 1986 for the purpose of getting the department and the curriculum organized and operational. * * * The position will be available 1 June 84. * * *

Petitioner responded to UMD's offer on February 9, 1984, in part, as follows:

> Based upon our telephone conversations on January 28, February 4 and 8, it is my understanding that the above position carries an immediate tenure * * * with two months summer salary guaranteed during 1984, 1985, and 1986. * * *

Petitioner requested two years' leave without pay from Cal Poly; petitioner was granted one year leave without pay, and was instructed to apply for a second year. After completing one year at UMD, petitioner requested and was granted an additional one year's leave without pay.

During 1984, petitioner and his former wife, Susan Tseng, were having marital difficulties and ultimately separated. Petitioner testified that they reconciled prior to his beginning employment with UMD, and that Susan Tseng was planning on joining him in Minnesota. However, the record reflects otherwise. In response to a

motion filed by Susan Tseng, the Superior Court of California, County of San Luis Obispo (hereafter referred to as the Superior Court) on April 19, 1984, issued a temporary restraining order prohibiting petitioner from entering the marital home. Moreover, on August 31, 1984, Susan Tseng was awarded exclusive use of the marital home. On October 28, 1985, the Superior Court issued a Judgment of Dissolution terminating petitioner's marriage; however, all other issues were reserved for further disposition.

On December 26, 1985, a civil bench warrant was issued for petitioner's arrest because petitioner had failed to comply with certain orders of the Superior Court. Petitioner testified that the bench warrant prohibited him from returning to California, and that, when the bench warrant was rescinded, he returned to California. However, the bench warrant was rescinded on January 22, 1987, and petitioner did not terminate his employment with UMD until February 17, 1988.[2]

Petitioner deducted the respective amounts of $6,933 and $9,381 in 1985 and 1986 as away from home business expenses.[3] Respondent disallowed these expenses on the

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[2] After negotiations, petitioner and UMD entered into a terminal leave agreement dated February 17, 1988, containing the following clause:

2. Professor Tseng * * * will receive one and one-half academic year's salary paid semi-monthly or in lump sum payments for the period September 1, 1988 through May 31, 1989 and September 1, 1989 through January 15, 1990.

[3] The parties have stipulated that petitioner incurred expenses for meals, lodging, dry cleaning, phone bills, and

ground that petitioner's tax home during 1985 and 1
was Duluth, Minnesota, and, thus, the expenses clain
by petitioner are nondeductible personal expenses un
section 262. Petitioner contends that his tax home w
San Luis Obispo, California; thus, his unreimburs
travel expenses while at UMD are deductible under s
tion 162(a)(2) as traveling expenses while "away fr
home".

Section 162(a)(2) allows a deduction for "travel
expenses * * * while away from home in the pursuit o
trade or business". Under section 162(a)(2), "travel
expenses" include amounts expended for meals and lo
ing other than amounts which are lavish or extravag
under the circumstances. To qualify for this deducti
three conditions must be met: (1) The expenses must
ordinary and necessary; (2) the expenses must have b
incurred while the taxpayer is "away from home"; and
the taxpayer must have incurred the expenses in purs
of a trade or business. *Commissioner v. Flowers*, 326 U
465 (1946); *Cockrell v. Commissioner*, 321 F.2d 504, 507 (
Cir. 1963), affg. 38 T.C. 470 (1962).

As a general rule, a taxpayer's principal place
business constitutes the "tax home", even though
personal residence of the taxpayer is in another city o
not in the same vicinity as the place of employme
Mitchell v. Commissioner, 74 T.C. 578, 581 (1980); *Krol
Commissioner*, 49 T.C. 557, 561-562 (1968). A recogni

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commuting in Minnesota totalling $6,932.91 and $9,271.35
1985 and 1986, respectively.

exception to this rule exists where the taxpayer's employment in another vicinity is temporary as opposed to indefinite in duration. *Peurifoy v. Commissioner,* 358 U.S. 59 (1958); *Horton v. Commissioner,* 86 T.C. 589, 593 (1986). If the employment is temporary, the tax home is considered to be the place of the taxpayer's residence; whereas, if the employment is indefinite, the tax home is the location of the employment. *Kroll v. Commissioner, supra.*

Employment is temporary if it can be expected to last for only a short period of time. *Mitchell v. Commissioner, supra* at 581; *Tucker v. Commissioner,* 55 T.C. 783 (1971). Employment must be temporary in contemplation at the time of its inception. *McCallister v. Commissioner,* 70 T.C. 505, 509 (1978). No single element is determinative of the factual issue of temporariness. *Norwood v. Commissioner,* 66 T.C. 467, 470 (1976). A job position may begin as temporary employment for a taxpayer and become indefinite employment. *Chimento v. Commissioner,* 52 T.C. 1067 (1969), affd. 438 F.2d 643 (3d Cir. 1971). Moreover, a taxpayer's desire to return to his former place of residence does not make employment temporary in those circumstances where employment would otherwise be indefinite. *Schmieder v. Commissioner,* T.C. Memo. 1984-56.

We do not believe petitioner's employment at UMD was temporary. UMD's offer of employment and petitioner's confirmation of such offer, provided that petitioner would be guaranteed a salary through August 1986. Thus, at the outset, petitioner viewed his employment with UMD to last at least 26 months. Additionally, petitioner bargained for, and was given, indefinite tenure by UMD. While petitioner may have intended to return to Cal Poly (and Cal Poly believed petitioner was going to

return), in 1984, petitioner did not have any fixed date in mind to return. As such, his stay at UMD is perceived to be indefinite, and, therefore, he was not "away from home" for purposes of section 162(a)(2). Accordingly, for the foregoing reasons, we sustain respondent on this issue.

Alimony Payments

Petitioner claimed alimony deductions for 1985 and 1986 in the respective amounts of $9,126.20 and $11,518.60. Respondent contends that petitioner is not entitled to an alimony deduction based on lack of substantiation. Alternatively, respondent contends that if the Court determines that petitioner is entitled to alimony deductions in the amounts claimed, petitioner's deduction for home interest expense should be disallowed as a duplicative deduction; i.e., petitioner claimed alimony deductions and home interest deductions for the same payments.

Petitioner and Susan Tseng were divorced on October 28, 1985. The divorce decree incorporated the provisions of an order issued by the Superior Court on December 21, 1984, which provided, in part:

> On the 1st calendar day of each month commencing Oct. 1, 1984 [petitioner] shall pay [Susan] the sum of $970.00. [Susan] shall timely pay the mortgage payment. [Petitioner] shall not be entitled to reimbursement for any monies paid on the mortgage pendente lite. [Petitioner] shall pay in a timely manner property taxes and insurance on the family residence until further order of this court.

On October 28, 1986, the Superior Court, modified the December 21, 1984, order effective retroactively to October 1, 1986. The modification provided as follows:

> The previous order as to spousal support filed on December 21, 1984 is modified effective October 1, 1986. Based upon the net earnings of the [petitioner] and the net earning capacity of [Susan] as set forth above, the [petitioner] shall pay to [Susan] the sum of $550.00 per month as and for spousal support commencing on October 1, 1986. These payments shall become due and payable on the first day of each and every month thereafter until further order of the Court, or they shall terminate upon the death of [Susan].
>
> [Susan] shall assume exclusive responsibility for mortgage encumbrance due and owing the family residence located at 446 Highland Drive in San Luis Obispo, California and the property taxes and insurance due thereon. These payments which were formerly being made from the parties [sic] Fidelity Daily Income Trust (FDIT) shall now be paid directly by [Susan] commencing October 1, 1986.
>
> 3. The Court confirms the previous order filed on December 21, 1984 regarding payment of spousal support, in the amount of $970.00 per month, payable by [petitioner] to [Susan] commencing October 1, 1984 and continuing to become due on the first day of each month thereafter.

Petitioner testified that he made payments to the holder of the mortgage on the marital home in lieu of making alimony payments to Susan Tseng. Section 215(a)

provides a husband with a deduction for amounts paid by him during the year if these amounts are includable under section 71 in the gross income of his former or separated wife. *Yoakum v. Commissioner*, 82 T.C. 128, 134 (1984). Section 1.71-1T(b), Q&A-6, Temporary Income Tax Regs., 49 Fed. Reg. 34455 (Aug. 31, 1984), answers the question of whether payments *to a third party* by one spouse may qualify as alimony. While the general answer to the question is "yes," the regulation also states: "Any payments to maintain property owned by the payor spouse and used by the payee spouse (including mortgage payments * * *) are not payments on behalf of a spouse even if those payments are made pursuant to the terms of the divorce or separation instrument." In other words, if petitioner pays the mortgage on property which he owns, but in which his former wife, Susan Tseng, resides, the payments are not alimony. Indeed, such payments would be enhancing petitioner's ownership interest. Thus, payments made to the mortgage holder do not constitute alimony. Accordingly, petitioner is not entitled to deduct such payments as alimony.[4]

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[4] Petitioner, did claim, and was allowed, a home mortgage interest deduction. However, the record reflects that until October 1, 1986, the payments were made from the Fidelity Income Trust (FDIT) account, a joint account of petitioner and Susan Tseng. Thus, petitioner only paid one-half of the mortgage, the other half was paid by Susan Tseng via her interest in the community funds. Nevertheless, petitioner deducted the entire amount of home mortgage interest paid during the years at issue. However, in the notice of deficiency, respondent did not determine that petitioner was only entitled to one-half of the interest claimed. Therefore, we will not hold otherwise.

Additionally, at trial, petitioner contended that pursuant to a court order dated October 28, 1986, he made additional alimony payments to Susan Tseng in the amount of $2,200 which he failed to claim on his return.[5] However, petitioner's former wife was not called as a witness to corroborate his testimony as to these payments, and no other evidence, such as cancelled checks, was presented. The Superior Court's orders and divorce decree only establish petitioner's obligation to make payments, without proving in any way that such payments had in fact been made. *Campbell v. Commissioner,* T.C. Memo. 1986-375. We are not required to accept petitioner's self-serving and uncorroborated testimony, particularly where other and better evidence to prove the point in question was available. See *Wood v. Commissioner,* 338 F.2d 602, 605 (9th Cir. 1964), affg. 41 T.C. 593 (1964). Accordingly, we sustain respondent on this issue.

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[5] At trial, petitioner attempted to submit carbon copies of checks purportedly paid to Susan Tseng as alimony. Respondent objected to the admission of the carbon copies on the grounds that petitioner had failed to comply with the Court's Pretrial Order that parties, not less than 20 days prior to trial should, inter alia, exhibit to each other any documentary evidence intended to be offered at trial. The purpose of the Court's Pretrial Order was to avoid surprise, promote stipulation of uncontroverted facts and exhibits, and shorten trial time. We sustain respondent's objection. However, even if admitted, carbon copies of written checks do not establish that such checks were ever paid.

Dependency Exemptions and Head of Household Statu

Petitioner claimed a dependency exemption for h mother, Mei-Yung Chou Tseng, for 1985, and, for 1986, h claimed dependency exemptions for both his mother an nephew, Chin-Pong Tseng. During the years at issu petitioner's mother and nephew were Chinese citizer who resided in China. Respondent disallowed the exemp tions contending that petitioner's relatives failed to qua ify as dependents under the citizenship or residency tes

Section 151(a) and (c)(1) allows a taxpayer a dedu tion for dependents as defined in section 152(a), provide certain requirements are met. Section 152(a)(4) and (provides that a taxpayer's mother or nephew may quali as a dependent; however, such claimed dependent mu meet the citizen or residency test. This test requires th the dependent be a U.S. citizen, or U.S. national, resident of the United States, Canada, or Mexico som time during the calendar year in which the taxable ye of the taxpayer begins. Sec. 152(b)(3).[6] Petitioner mother and nephew fail this test. Moreover, the fact th petitioner's nephew is a full-time student in China do not alter this result. Accordingly, we sustain responde on this issue.

Petitioner claimed head of household status on h 1985 return. As we have determined that petitioner

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[6] Petitioner contends that such provision is unconstitutio al. However, the constitutionality of this section has be repeatedly upheld. See *Habeeb v. Commissioner*, 559 F.2d 435 (5 Cir. 1977), affg. T.C. Memo. 1976-259; *Wexler v. Commissioner*, 5 F.2d 843 (6th Cir. 1974), affg. T.C. Memo. T.C. Memo. 1974-11 *Barr v. Commissioner*, 51 T.C. 693 (1969).

mother did not qualify as a dependent, he is not entitled to claim head of household status. *Stelzig v. Commissioner*, T.C. Memo. 1980-20. Accordingly, we sustain respondent on this issue.

General Business Credit

Petitioner claimed a general business credit of $756.70 on his 1985 tax return. The credit was for his automobile, two computers, and an answering machine. Respondent disallowed the credit based on her determination that the property was not used in petitioner's trade or business, and, therefore, did not constitute depreciable property.

The investment credit is allowable for qualified investment in section 38 property, which is defined to include only property having a useful life of 3 years or more with respect to which depreciation is allowable. Sec. 48(a)(1).

At trial, petitioner testified that the automobile was used primarily for commuting. Commuting does not constitute a business purpose. Accordingly, petitioner has failed to establish that the automobile was used in a trade or business.

With regard to the credit claimed for the computer equipment, petitioner testified that he purchased such items to examine their hardware and see how they work. However, petitioner had access to many computers at UMD, and, based on petitioner's testimony, we conclude that the purchase of such items was for petitioner's personal research, rather than for use in petitioner's trade or

business. That is, rather than being assets used in a trad
or business and depreciable over their useful lives, thes
computers were purchased for petitioner's personal us
examined, and apparently discarded. The purpose fo
which they were bought was short term in nature. Thu
they would not be depreciable, and hence no investmer
tax credit would be allowable. Additionally, petitione
failed to offer any testimony regarding the answerin
machine. Accordingly, we sustain respondent's dete
mination on this issue.

Net Operating Loss Carryforward

Petitioner claimed a net operating loss carryforwar
in the amount of $8,423 on his 1985 return based on losse
sustained in 1982 with respect to his investment in oil an
gas leases. Petitioner contends that he is entitled to th
net operating loss carryforward because such loss const
tuted a business loss. Additionally, petitioner contend
that respondent should be estopped from disallowing th
net operating loss carryforward, based on respondent
allowance of the carryforward in previous years. Respo
dent disallowed the net operating loss carryforwar
based on her determination that such loss was attributa
ble to a nonbusiness activity.

In 1978, petitioner began to participate in a Feder
program for the noncompetitive leasing of governmer
lands for oil and gas exploration and developmen
administered by the Bureau of Land Management (BLM
In awarding leases under the noncompetitive progra
BLM utilized a simultaneous filing procedure (i.e., a lo
tery system), which provided all applicants with an equ

chance to obtain leases on Federal lands available for releasing. Applications to lease designated parcels were submitted, signed, completed, and accompanied by a nonrefundable filing fee. An applicant was only allowed to file one application for each numbered parcel on the list; however, the applicant could make as many filings as there were available parcels.

Pursuant to the program, petitioner participated in the oil and gas lease lottery. When petitioner successfully acquired leasehold interests in parcels of land owned by the Federal government, he subleased the properties to oil and gas companies in return for royalty interests. In 1982, petitioner and Susan Tseng paid $82,045 in filing fees for participation in the lottery program and successfully acquired 7 leases. They received oil and gas income in 1982 of $38,912.75. In addition, they paid $11,569 in net rental expense and $2,949.54 in other miscellaneous leasing expenses. As a result, they claimed a net operating loss in the amount of $30,466.81. Petitioner and his former wife elected to waive the carryback period under section 172(b)(2)(C). Petitioner, in 1983 and 1984, has taken deductions against income, based on the alleged net operating loss carryforward in the respective amounts of $15,233.41 and $7,869. Petitioner's 1984 tax return was not a joint return.

We need not determine whether petitioner's oil and gas activity constituted a trade or business, because petitioner, in 1985, had no remaining net operating loss carryforward. California is a community property state, and, as such, one-half of the net-operating loss claimed on the 1982 return is allocable to petitioner's former wife. Sec. 1.172-7(d)(1). Having deducted $15,233.41 on the joint

1983 return, only $15,233.40 remained as a net operati
loss carryforward. However, subsequent to 1983, pe
tioner filed separate returns. Thus, petitioner's share
the remaining net operating loss was $7,616.70. Petition
claimed a net operating loss carryforward in the amou
of $7,869 on his 1984 return. Accordingly, petitioner is n
entitled to a net operating loss carryforward in 1985.

**Taxability of Earnings from California Polytechnic Un
versity**

During 1983, rather than being paid for the quart
petitioner taught, petitioner "banked" the quarter a
was supposed to take a paid quarter off in 1984. Ho
ever, Cal Poly required petitioner to teach in 1984, an
therefore, paid him for the banked quarter in 1985. Pe
tioner contends he erroneously reported the enti
amount of income, $10,734.15, received from Cal Poly
his 1985 return. Petitioner alleges that such income w
earned in a prior year, before he was separated a
subsequently divorced from Susan Tseng, and, therefo
constitutes community property and that only 50-perce
of the earnings are taxable to him. Respondent conten
that such income does not constitute community pro
erty, and the entire amount received is taxable to pe
tioner.

California is a community property State, and, und
California law, a wife generally has a present interest
one-half of any personal property that is acquired by h
husband during the marriage. Cal. Civ. Code secs. 51
5110 (West 1983). Her one-half community property int
est plainly extends at least to her husband's earnin

United States v. Malcolm, 282 U.S. 792 (1931); *Simmons v. Cullen,* 197 F. Supp. 179, 181 (N.D. Cal. 1961). However, earnings of a husband while living separate and apart from his wife are the separate property of the husband. Cal. Civ. Code sec. 5118 (West 1983).

In the instant case, petitioner earned the Cal Poly income during a year when petitioner and Susan Tseng were residing together and deferred payment of the income to 1985, when they were divorced. Thus, the amount received by petitioner in 1985 constitutes community property. See *Winn v. Winn,* 299 P.2d 721 (Cal. Ct. App. 1956).

However, section 66(b) allows respondent to deny petitioner the benefit of the applicable community property laws with respect to any income if the taxpayer acted as if solely entitled to such income and failed to notify his spouse before the due date of the return for the taxable year in which the income was derived of the nature and amount of such income. Based on this record, it is clear that petitioner acted as if the income he received in 1985 from Cal Poly was solely his. Petitioner failed to notify Susan Tseng of the nature and amount of income. Thus, section 66(b) applies, and we hold that the entire amount of income received in 1985 from Cal Poly is taxable to petitioner.

Credit for Amount Levied

At trial, petitioner contended that $783.63 and $500 were obtained by the IRS by levy for his 1985 tax liability and that such amounts should be credited against any deficiency determined for 1985. Petitioner has failed to

present any evidence to establish that there were a
levies issued by respondent which pertained to his 19
tax liability. Moreover, respondent's records do not reve
a levy for either his 1985 or 1986 tax liability. Wh
appears to have occurred is that respondent, in 198
served levies on the FDIT account and on UMD wi
regard to unpaid *1984* tax liabilities. Moreover, it is al
possible that refunds due petitioner were applied
unpaid tax liabilities for 1983 and 1984.

This Court has limited authority and may exerc
jurisdiction only to the extent expressly provided by Co
gress. Sec. 7442; *Pyo v. Commissioner*, 83 T.C. 626, 6
(1984); *Kluger v. Commissioner*, 83 T.C. 309 (1984); *Medei*
v. Commissioner, 77 T.C. 1255, 1259 (1981). Our jurisdicti
is premised upon the issuance of a notice of deficiency
respondent and the timely filing of a petition for redet
mination of the deficiency by the taxpayer. The fact th
moneys were collected by respondent during a ye
before the Court does not give us jurisdiction over su
matter. Once respondent has collected funds and appli
them to an account for another taxable year, petitione
remedy is to seek a refund for such taxable year by fili
claims for refund for that taxable year. Moreover, th
Court has jurisdiction as to an allegedly erroneous le
only with respect to the deficiency. Sec. 6213(a); see al
section 7429(b)(2)(B).

To reflect the foregoing,

Decision will be

entered for respondent.

TREASURY NEWS (LOGO)

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
April 30, 1984

CONTACT:
CHARLES POWERS
(202) 566-2041

THE UNITED STATES AND THE PEOPLE'S REPUBLIC OF CHINA SIGN AN INCOME TAX TREATY

The Treasury Department today announced that an income tax treaty between the United States and the People's Republic of China was signed in Beijing on April 30, 1984 by President Ronald Reagan and Premier Zhao Ziyang. The proposed treaty and an accompanying protocol and exchange of notes will be sent to the Senate for its advice and consent to ratification.

The proposed treaty is a comprehensive agreement to avoid double taxation of all types of income and to provide for cooperation between the tax authorities of the two countries to prevent evasion of income taxes. It is based on the model income tax treaties published by the Organization for Economic Cooperation and Development, the United Nations and the United States Treasury Department. It includes rules concerning when, and to what extent, each country may tax income derived in that country by residents of the other country. For example, it provides that each country may tax business profits of residents of the other country only to the extent that the profits are attributable to a "permanent establishment" in the first country. Under the treaty definition, a place of

business such as an office, warehouse or factory cons
tutes a permanent establishment; but certain activiti
such as collecting information or making sales throu
independent brokers, do not constitute a permane
establishment, and other activities, such as constructi
or oil drilling, constitute a permanent establishment o
if carried on for a specified time period. Income fr
employment for periods of less than six months of
year is generally exempt from tax in the country visit
And special exemptions are available to visiting studen
teachers and researchers.

In addition, each country agrees to limit to not m
than 10 percent its tax on dividends, interest and royalt
derived by residents of the other country. In the abse
of a treaty the United States typically would impose a
of 30 percent on dividends, interest and royalties paid
nonresidents, and China generally would tax such pa
ments at 20 percent. A special

* * *

TAX AGREEMENT WITH THE PEOPLE'S REPUBLIC OF CHINA

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF TAX EVASION WITH RESPECT TO TAXES ON INCOME, TOGETHER WITH A SUPPLEMENTARY PROTOCOL AND EXCHANGE OF NOTES, SIGNED AT BEIJING ON APRIL 30, 1984

(SEAL)

AUGUST 10, 1984. – Agreement was read the first time, and together with the accompanying papers, referred to the Committee on Foreign Relations and ordered to be printed for the use of the Senate

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U.S. GOVERNMENT PRINTING OFFICE
31-118 O WASHINGTON:1984

LETTER OF TRANSMITTAL

THE WHITE HOUSE, *August 10, 1984.*

To the Senate of the United States:

I transmit herewith for Senate advice and consent to ratification the Agreement between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, together with a supplementary protocol and exchange of notes, signed at Beijing on April 30, 1984. I also transmit the report of the Department of State on the Agreement.

The Agreement is the first complete income tax treaty between the two countries. A limited treaty concerning the taxation of income from international shipping and air transportation, signed at Beijing on March 5, 1982, was approved by the Senate on July 27, 1983 and is now in force.

The Agreement is based on model income tax treaties developed by the Department of the Treasury, the Organization for Economic Cooperation and Development, and the United Nations. The provisions of the Agreement are reciprocal and, like other tax treaties, represent a balanced package of benefits and concessions.

The Agreement will contribute to a long-run expansion of economic relations between the two countries by providing clear rules as to the tax consequences of investing or working in the other country. It reduces the tax which residents of one country must pay to the other on

certain types of income, such as dividends, interest, and royalties and provides limited exemptions for visiting teachers, researchers and students. The Agreement also assures nondiscriminatory taxation in the host country, and provides a mechanism for cooperation between the tax authorities to try to resolve any potential problems of double taxation.

I recommend that the Senate give early and favorable consideration to the Agreement and give its advice and consent to ratification.

RONALD REAGAN.

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, July 24, 1984.

THE PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Agreement between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, together with a supplementary protocol and exchange of notes, which you signed at Beijing on April 30, 1984.

The agreement is the first complete income tax treaty to be signed with the People's Republic of China. A

limited treaty affecting the taxation of income from international shipping and aircraft operations was signed at Beijing on March 5, 1982, (97th Cong. 2d. Sess., Senate Treaty Doc. No. 97-24, June 16, 1982) and is presently in force.

The present agreement is based on model income tax treaties prepared by the Department of the Treasury, the United Nations, and the OECD. Like other United States tax treaties, it provides rules for determining the extent to which each country may tax particular types of income. Where the host country may tax, it agrees to impose its income tax in a non-discriminatory manner. The agreement provides that the country of residence will give a foreign tax credit for income tax paid to the other country. If any potential problems of double taxation should arise, the tax officials of the two countries agree to consult to try to resolve them.

All provisions of the agreement are reciprocal. Some will benefit especially United States investors. For instance, investors will know before undertaking a transaction in China what the income tax consequences will be. Business profits will not be taxable by China unless attributable to a "permanent etablishment", as defined in the agreement. Taxation by China of the remuneration of United States citizens who are self-employed or employed by private firms is generally permissible only if they remain in China more than six months a year. In addition, the agreement limits the tax which each country may impose on dividends, interest and royalties derived by residents of the other country to no more than 10 percent in each case.

The protocol clarifies certain provisions of the agreement and also provides for cooperation between the tax officials of the two countries to prevent tax evasion.

In the accompanying exchange of notes, the United States agrees to amend the treaty with China to include a "tax sparing credit" if such a provision is ever included in a United States tax treaty with another country. Presently, the United States does not permit a "tax sparing" credit, i.e. a foreign tax credit for the statutory full amount of the foreign tax even if, in fact, that tax has been reduced or waived as an incentive. It is a firm element of U.S. policy that a foreign tax credit be given only for foreign income taxes actually paid.

The agreement provides that the Contracting States shall notify each other in writing, through diplomatic channels, upon the completion of their respective legal procedures to bring the agreement into force. The agreement will enter into force on the thirtieth day after the date of the latter of such notifications and shall take effect with respect to income derived during taxable years beginning on or after the first day of January next following the date on which the agreement enters into force.

A technical memorandum explaining in detail the provisions of the agreement is being prepared by the Department of the Treasury and will be submitted separately to the Senate Committee on Foreign Relations.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the agreement. It has the full approval of both Departments.

Respectfully submitted,

GEORGE P. SHULTZ.

AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF TAX EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the People's Republic of China,

Desiring to conclude an Agreement for the avoidance of double taxation and the prevention of tax evasion with respect to taxes on income,

Have agreed as follows:

ARTICLE 1

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2

1. The taxes to which this Agreement applies are

(a) in the People's Republic of China:

(i) the individual income tax;

(ii) the income tax concerning joint ventures with Chinese and foreign investment;

(iii) the income tax concerning foreign enterprises;

(iv) the local income tax

(hereinafter referred to as "Chinese tax").

(b) in the United States of America: the Federal income taxes imposed by the Internal Revenue Code

(hereinafter referred to as "United States tax").

2. The Agreement shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Agreement in addition to, or in place of, those referred to in paragraph 1. Within an appropriate time period, the competent authorities of the Contracting States shall notify each other of any substantial changes which have been made in their respective taxation laws.

ARTICLE 3

1. In this Agreement, unless the context otherwise requires,

(a) the term "the People's Republic of China", when used in a geographical sense, means all the territory of the People's Republic of China, including its territorial sea, in which the laws relating to Chinese tax are in force, and all the area beyond its territorial sea, including the sea-bed and subsoil thereof, over which the People's Republic of China has jurisdiction in accordance with international law and in which the laws relating to Chinese tax are in force:

[Pages 2 through 13 are not reproduced as they do not contain any material relevant to this matter]

same conditions as if they had been paid to a resident of the first-mentioned Contracting State.

4. Enterprises of a Contracting State, the capital which is wholly or partly owned or controlled, directly indirectly, by one or more residents of the other Contrac ing State, shall not be subjected in the first-mentione Contracting State to any taxation or any requireme connected therewith which is other or more burdenson than the taxation and connected requirements to whi other similar enterprises of the first-mentioned Contrac ing State are or may be subjected.

ARTICLE 24

1. Where a person considers that the actions of o or both of the Contracting States result or will result f him in taxation not in accordance with the provisions this Agreement, he may, irrespective of the remedies pr vided by the domestic law of those Contracting State present his case to the competent authority of the Co tracting State of which he is a resident or, if his ca comes under paragraph 1 of Article 23, to that of t Contracting State of which he is a national. The case mu be presented within three years from the first notificati of the action resulting in taxation not in accordance wi the provisions of this Agreement.

2. The competent authority shall endeavor, if t objection appears to it to be justified and if it is not its able to arrive at a satisfactory solution, to resolve the ca through consultation with the competent authority of t other Contracting State, with a view to the avoidance taxation which is not in accordance with this Agreemer

Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Agreement. They may also consult together for the elimination of double taxation in cases not provided for in this Agreement.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of paragraphs 2 and 3. To facilitate reaching a mutual agreement, the competent authorities of both Contracting States may meet for an oral exchange of opinions.

ARTICLE 25

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Agreement or of the domestic laws of the Contracting States concerning taxes covered by this Agreement insofar as the taxation thereunder is not contrary to this Agreement, in particular for the prevention of fraud or evasion of such taxes. The exchange of information is not restricted by Article 1. Any information received by a Contracting State shall be treated as secret and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered

by this Agreement. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

(a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

ARTICLE 26

Nothing in this Agreement shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

ARTICLE 27

Each of the Contracting States shall notify the other Contracting State in writing, through diplomatic channels, upon the completion of their respective legal procedures to bring this Agreement into force. The

Agreement shall enter into force on the thirtieth day after the date of the latter of such notifications and shall take effect as respects income derived during taxable years beginning on or after the first day of January next following the date on which this Agreement enters into force.

ARTICLE 28

This Agreement shall remain in force indefinitely, but either Contracting State may terminate the Agreement by giving notice to the other Contracting State in writing through diplomatic channels on or before June 30 in any calendar year after five years from the date on which this Agreement enters into force. In such event, the Agreement shall cease to have effect with respect to income derived during taxable years beginning on or after the first day of January of the year following that in which the notice of termination is given.

DONE at Beijing on the 30th day of April, 1984, in duplicate, in the Chinese and English languages, the two texts having equal authenticity.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	FOR THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA:
/s/ Ronald Reagan	/s/ Zhao Ziyang

EXPLANATION OF PROPOSED INCOME TAX TREATY (AND PROPOSED PROTOCOL) BETWEEN THE UNITED STATES AND THE PEOPLE'S REPUBLIC OF CHINA

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON JULY 30, 1985

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

[SEAL]

JULY 29, 1985

U.S. GOVERNMENT PRINTING OFFICE
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INTRODUCTION

This pamphlet[1] provides an explanation of the proposed income tax treaty, as modified by the proposed protocol, between the United States and the People's Republic of China. The proposed treaty and protocol were both signed on April 30, 1984. The proposed treaty was amplified by an exchange of notes signed the same day. The Senate Committee on Foreign Relations has

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty (and Proposed Protocol) between the United States and the People's Republic of China (JCS-28-85), July 29, 1985.*

scheduled a public hearing on the proposed treaty and protocol on July 30, 1985.

The proposed treaty is the first comprehensive income tax treaty between the United States and the People's Republic of China. An agreement between the two countries governing the taxation of shipping and aircraft income only was signed on March 5, 1982, and is currently in force.[2] The proposed treaty does not alter the tax rules for shipping and aircraft income set forth in that prior agreement.

The proposed treaty is similar to other recent U.S. income tax treaties, the 1981 proposed U.S. model income tax treaty ("U.S. model treaty"), and the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model treaty"). However, there are certain deviations from those documents. In addition, a number of the proposed treaty's provisions follow the United Nations model income tax treaty between developed and developing countries ("United Nations model treaty").

The first part of the pamphlet summarizes the principal provisions of the proposed treaty. The second part presents a discussion of the issues that the proposed treaty raises. The third part provides an overview of U.S. tax laws relating to international trade and investment and U.S. tax treaties in general. This is followed in part

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[2] For a description of the agreement between the United States and the People's Republic of China governing the taxation of shipping and aircraft income, *see* Senate Comm. on Foreign Relations, Report on Treaty Doc. 97-24, S. Exec. Rep. No. 14, 98th Cong., 1st Sess. (1983).

four by a detailed explanation of the proposed treaty and protocol.

[Pages 2 through 48 are not reproduced as they do not contain any material relevant to this matter]

Article 25. (Exchange of information)

This article forms the basis for cooperation between the two countries in their attempts to deal with avoidance or evasion of their respective taxes and to obtain information so that they can properly administer the treaty. It follows the exchange of information article of the U.S. model treaty, with some significant modifications. It is also similar to the exchange of information articles found in the United Nations and OECD model treaties.

The proposed treaty provides for the exchange of information that is necessary to carry out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes to which the treaty applies insofar as the taxation under those domestic laws is not contrary to the treaty. Following the United Nations model treaty rather than the U.S. model, the proposed treaty states that such exchange of information will be, in particular, for the prevention of fraud or evasion of the covered taxes.

The exchange of information under the proposed treaty is not restricted by Article 1; thus, third-country residents are covered. The U.S. model treaty provides for the exchange of information regarding all taxes imposed by either country (whether or not otherwise covered by the treaty). The exchange of information provided for in the proposed treaty is more limited: the proposed treaty

authorizes the exchange only of information regarding taxes generally covered by the treaty (Article 2).

Any information exchanged is to be treated as secret. Exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the treaty applies. Such persons or authorities can use the information for such purposes only. They may disclose the information in public court proceedings or in judicial decisions. Persons involved in the administration of taxes include legislative bodies involved in oversight of the administration of taxes, including their agents such as, for example, the U.S. General Accounting Office, with respect to such information as they consider necessary to carry out their oversight responsibilities.

The proposed treaty contains limitations on the obligations of the countries to supply information. A country is not required to carry out administrative measures at variance with the law and administrative practice of either country, or to supply information which is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

The U.S. model treaty requires that, upon an appropriate request for information, the requested country obtain the information to which the request relates in the

same manner and to the same extent as if its tax were at issue. It also requires that, where specifically requested by the competent authority of one country, the competent authority of the other country provide the information in the form requested. The proposed treaty does not contain these requirements.

The U.S. model treaty also provides that each country will collect taxes for the other country to the extent necessary to insure that benefits of the treaty are not going to persons not entitled to those benefits. The proposed treaty does not contain such a collection provision.

Article 26. (Diplomatic agents and consular officers)

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the privileges of diplomatic agents or consular officials under the general rules of international law or the provisions of special agreements. Accordingly, the treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. Because the saving clause does not apply to Chinese taxes at all, U.S. diplomats who are considered Chinese residents will not be subject to Chinese tax on their diplomatic salaries. Because the saving clause does not apply to U.S. taxes under this article in the case of U.S. residents (who are not U.S. citizens), Chinese diplomats who are considered U.S. residents similarly will not be subject to U.S. tax on their diplomatic salaries.

Article 27. (Entry into force)

The countries are to notify each other in writing, through diplomatic channels, upon the completion of their respective legal procedures to bring the proposed treaty into force. The proposed treaty and proposed protocol will enter into force on the 30th day after the latter of the notifications.

These entry-into-force rules differ from those of the U.S. model treaty which require the countries to exchange instruments of ratification as soon as possible and provide for entry into force upon that exchange.

The proposed treaty and protocol will be effective for income derived in taxable years beginning on or after the January 1st next following the date on which the treaty and protocol enter into force.

Article 28. (Termination)

This proposed treaty will remain in force indefinitely, but either country may terminate it by giving notice in writing through diplomatic channels on or before June 30th in any calendar year after five years from the date on which the treaty enters into force. If a termination occurs, it will be effective with respect to income derived during taxable years beginning on or after the January 1st of the year following that in which the notice of termination is given.

TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF TAX EVASION WITH RESPECT TO TAXES ON INCOME

The Agreement, an accompanying Protocol, and an exchange of letters were signed in Beijing on April 30, 1984. Hereafter, the term "Agreement" refers to the three documents. The term "Agreement" has the same meaning as "Treaty" or "Convention", and the Agreement is subject to the same ratification requirements and has the same force as a Convention or Treaty.

The Agreement is based on the model income tax conventions published by the Organization for Economic Cooperation and Development in 1977, the United Nations in 1980, and the U.S. Treasury Department in 1981.

This technical explanation is an official guide to the Agreement. It reflects policies behind particular provisions as well as understandings reached with respect to the interpretation and application of the Agreement.

Article 1.

This article states the general rule that the persons affected by the Agreement are residents of the United States or China or of both countries. The term "resident" is defined in Article 4. Certain articles may also apply to nonresidents; see, for example, Article 23, which concerns

nondiscrimination, and Article 25, concerning exchanges of information. Article 1 is supplemented by Articles 1 and 2 of the Protocol.

Article 1 of the Protocol provides that the Agreement does not restrict any benefits provided by the laws of either Contracting State or by any other agreement between the Contracting States. This rule reflects the principle that a double taxation agreement should not increase the overall tax burden which would result in the absence of the Agreement. For example, if the Agreement permits a Contracting State to tax an item of income which under the law of that State is exempt from tax, the statutory exemption applies. A U.S. taxpayer, however, may not make inconsistent choices between the rules of the Internal Revenue Code ("the Code") and the rules of the Agreement.

[Pages 2 through 20 are not reproduced as they do not contain any material relevant to this matter]

Paragraph 2 provides that the competent authority to which the case is presented, if it considers the objection to be justified and if it is not itself able to arrive at a solution, shall endeavor to resolve the case through consultation with the competent authority of the other Contracting State. Any agreement reached shall be implemented without regard to any statutory time limits of the Contracting States. Thus, if a Contracting State agrees that its tax was overstated, a refund of the excess tax paid will be made, even though the statute of limitations under domestic law may have expired. The waiver of the statute of limitations applies only for refunds and not for the imposition of additional taxes.

Paragraph 3 provides that the competent authorities shall endeavor to resolve by mutual agreement any difficulties or doubts which may arise in the interpretation or application of the Agreement. For example, the competent authorities may agree on the same allocation of income, deductions, credits, or allowances, on the same characterization of items of income, and on a common meaning of terms used in the Agreement. The competent authorities also may consult together to eliminate double taxation in cases not provided for in the Agreement. The authority to consider cases not covered in the Agreement is not a broad grant of authority to expand the scope of the Agreement, but is intended to permit the competent authorities to apply the principles of the Agreement to settle specific cases of double taxation which are not expressly addressed.

Paragraph 4 provides that the competent authorities may communicate with each other directly for the purpose of reaching agreements in accordance with this article.

Article 25.

This article provides for exchanges of information between the tax authorities of the two Contracting States to avoid double taxation and prevent fiscal evasion.

Paragraph 1 provides that the competent authorities shall exchange such information as is necessary for carrying out the provisions of the Agreement or of their domestic laws concerning taxes covered by the Agreement, in particular with the objective of preventing tax evasion. Such information may be provided whether or

not the requested Contracting State has a tax interest in the case in question. It also provides assurances that information so exchanged will be protected in the same manner as information obtained under domestic laws with respect to secrecy and disclosure. Persons involved in the administration of taxes covered by the Agreement include legislative bodies involved in the administration of taxes and their agents such as, for example, the U.S. General Accounting Office. Information may be dismissed to such persons, subject to the limitations of this article and the domestic law of the respective Contracting State.

Paragraph 2 explains that the obligation undertaken in paragraph 1 to exchange information does not require a Contracting State tc carry out measures contrary to the laws and administrative practice of either Contracting State, to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

Article 26.

This article clarifies that the Agreement does not affect taxation privileges of diplomatic or consular officials under other special agreements or under international law.

Article 27.

The Agreement is subject to approval in each Contracting State according to its legal requirements. Each State will notify the other, in writing, through diplomatic channels when those requirements have been completed.

The Agreement enters into force on the thirtieth day after the date of such notification. Once it enters into force, its provisions will take effect for income derived during taxable periods of the recipient beginning on or after January 1 of the year following the entry into force.

Article 28.

The Agreement remains in force indefinitely unless terminated by one of the Contracting States. Either Contracting State may terminate the Agreement after five years from the date on which it enters into force by giving at least six months prior notice through diplomatic channels prior to June 30. In that event, the Agreement will cease to have effect with respect to income derived during taxable years of the recipient beginning on or after January 1 following the termination date.

Protocol

A protocol accompanies and forms part of the Agreement.

The provisions of paragraphs 1 through 6 of the Protocol are discussed above in connection with Articles 1, 2, 3, 4 and 11 of the Agreement.

Paragraph 7 of the Protocol contains a protection against "treaty shopping." It provides that the competent authorities may through consultation deny the benefits of Articles 9, 10, and 11, concerning dividends, interest and royalties, to a company of a third country if that company becomes a resident of one of the

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INCOME TAX AGREEMENT (AND PROTOCOL) WITH THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA

REPORT

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON

TREATY DOC. 98-30, 98TH CONGRESS, 2ND SESSION INCOME TAX AGREEMENT (AND PROTOCOL) WITH THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA

DECEMBER 11 (Legislative Day, DECEMBER 9), 1985. – Ordered to be printed

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INCOME TAX AGREEMENT (AND PROTOCOL) WITH THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA

DECEMBER 11 (Legislative Day, DECEMBER 9), 1985. – Ordered to be printed

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Mr. EVANS, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Treaty Doc. 98-30]

The Committee on Foreign Relations, to which was referred the Agreement Between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, together with a Supplementary Protocol and Exchange of Notes, signed at Beijing on April 30, 1984, having considered the same, reports favorably thereon and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The principal purposes of the proposed income tax treaty between the United States and the Government of the People's Republic of China are to reduce or eliminate double taxation of income earned by citizens and residents of either country from sources within the other country, and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is

intended to continue to promote close economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries. It is intended to enable the countries to cooperate in preventing avoidance and evasion of taxes.

II. BACKGROUND

The proposed treaty and protocol were both signed on April 30, 1984. The proposed treaty was amplified by an exchange of notes signed the same day.

The proposed treaty is the first comprehensive income tax treaty between the United States and the People's Republic of China. An agreement between the two countries governing the taxation of shipping and aircraft income only was signed on March 5, 1982, and is currently in force. The proposed treaty does not alter the tax rules for shipping and aircraft income set forth in that prior agreement.

The treaty was transmitted to the Senate for advice and consent to its ratification on August 10, 1984. The Senate Committee on Foreign Relations held a public hearing on the proposed treaty and protocol on July 30, 1985.

III. SUMMARY OF TREATY (AND PROTOCOL)

The proposed treaty is similar to other recent U.S. income tax treaties, the 1981 proposed U.S. model income tax treaty ("U.S. model treaty"), and the model income tax treaty of the Organization for Economic Cooperation

and Development ("OECD model treaty"). However, there are certain deviations from those documents.

As in other U.S. tax treaties, the objectives of the treaty are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. For example, the treaty provides that neither country will tax business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 13). Similarly, the treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other will not be required to pay tax in the other unless their contact with the other exceeds specified minimums (Articles 13, 14, and 16). The proposed treaty provides that dividends, interest, royalties, capital gains, and certain other income derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 9, 10, 11, and 12). Generally, however, dividends, interests, and royalties received by a resident of one country from sources within the other country are to be taxed by the source country on a restricted basis (Articles 9, 10, and 11).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief of the potential double taxation by the country of residence allowing a foreign tax credit.

Like other U.S. tax treaties, the proposed protocol contains a "saving clause." Under this provision, the United States retains the right to tax its citizens and residents as if the treaty had not come into effect. In addition, the protocol contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of the country of under any other agreement between the two countries; that is, the treaty will only be applied to the benefit of taxpayers.

[Pages 3 through 23 are not reproduced as they do not contain any material relevant to this matter.]

VIII. EXPLANATION OF TREATY PROVISIONS

A detailed article-by-article explanation of the proposed income tax treaty between the United States and the People's Republic of China ("China"), as modified by the proposed protocol, is presented below, followed by separate explanations of the proposed protocol and the notes exchanged when the proposed treaty was signed.

The proposed protocol is unusual in that its signing occurred at the same time as the signing of the proposed treaty. Some of the provisions of the proposed protocol amend specific articles of the proposed treaty, while others do not. The proposed treaty and the proposed protocol, upon entry into force, will operate as one document, and it is of no consequence that some provisions appear in the proposed protocol while others appear in the body of the proposed treaty.

Article 1. (Personal scope)

Article 1 describes the persons who may claim the benefits of the treaty.

The proposed treaty applies to residents of the United States and to residents of China. Specific exceptions are designated in other articles and in the proposed protocol. This application follows other U.S. income tax treaties, the U.S. model treaty, and the OECD model treaty. The treaty also applies, in limited cases designated in other articles, to persons who are residents of neither China nor the United States. Article 4 defines the term "resident".

Article 2. (Taxes covered)

In general, in the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Internal Revenue Code (the "Code").

The proposed protocol provides that the United States may, with one exception, impose its personal holding company and accumulate earnings taxes notwithstanding the treaty; the protocol exempts Chinese companies from these two taxes if they are wholly owned, directly or indirectly, by the Chinese Government (or any wholly owned agency thereof) or one or more individual Chinese residents (who are not U.S. citizens). The proposed protocol also provides that the United States may impose its social security tax notwithstanding the treaty.

Because the proposed treaty applies to the Federal income taxes only, it does not cover the U.S. excise tax on

insurance premiums imposed under section 4371 of the Code. Accordingly, the United States may impose this tax without restriction.

In the case of China, the proposed treaty applies to the individual income tax, the income tax concerning joint ventures with Chinese and foreign investment, the income tax concerning foreign enterprises, and the local income tax.

[Pages 4 through 41 are not reproduced as they do not contain any material relevant to this matter.]

competent authorities might agree. However, the Committee intends that, as under the U.S. model, the competent authorities be authorized to agree to the allocation of income, deductions, credits, or allowances, to the determination of the source of income, and to the common meaning of terms.

The proposed treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of this mutual agreement article. It also authorizes them to meet together for an oral exchange of opinions in order to facilitate reaching an agreement. These provisions make clear that it is not necessary to go through diplomatic channels in order to discuss problems arising in the application of the treaty. They also remove any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or China.

Article 25. (Exchange of information)

This article forms the basis for cooperation between the two countries in their attempts to deal with avoidance or evasion of their respective taxes and to obtain information so that they can properly administer the treaty. It follows the exchange of information article of the U.S. model treaty, with some significant modifications. It is also similar to the exchange of information articles found in the United Nations and OECD model treaties.

The proposed treaty provides for the exchange of information that is necessary to carry out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes to which the treaty applies insofar as the taxation under those domestic laws is not contrary to the treaty. Following the United Nations model treaty rather than the U.S. model, the proposed treaty states that such exchange of information will be, in particular, for the prevention of fraud or evasion of the covered taxes.

The exchange of information under the proposed treaty is not restricted by Article 1; thus, third-country residents are covered. The U.S. model treaty provides for the exchange of information regarding all taxes imposed by either country (whether or not otherwise covered by the treaty). The exchange of information provided for in the proposed treaty is more limited: the proposed treaty authorizes the exchange only of information regarding taxes generally covered by the treaty (Article 2).

Any information exchanged is to be treated as secret. Exchanged information may be disclosed only to persons or authorities (including courts and administrative

bodies) involved in assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the treaty applies. Such persons or authorities can use the information for such purposes only. They may disclose the information in public court proceedings or in judicial decisions. Persons involved in the administration of taxes include legislative bodies involved in oversight of the administration of taxes, including their agent such as, for example, the U.S. General Accounting Office, with respect to such information as they consider necessary to carry out their oversight responsibilities.

The proposed treaty contains limitations on the obligations of the countries to supply information. A country is not required to carry out administrative measures at variance with the law and administrative practice of either country, or to supply information which is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

The U.S. model treaty requires that, upon an appropriate request for information, the requested country obtain the information to which the request relates in the same manner and to the same extent as if its tax were at issue. It also requires that, where specifically requested by the competent authority of one country, the competent authority of the other country provide the information in the form requested. The proposed treaty does not contain these requirements.

The U.S. model treaty also provides that each country will collect taxes for the other country to the extent necessary to insure that benefits of the treaty are not going to persons not entitled to those benefits. The proposed treaty does not contain such a collection provision.

Article 26. (Diplomatic agents and consular officers)

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the privileges of diplomatic agents or consular officials under the general rules of international law or the provisions of special agreements. Accordingly, the treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. Because the saving clause does not apply to Chinese taxes at all, U.S. diplomats who are considered Chinese residents will not be subject to Chinese tax on their diplomatic salaries. Because the saving clause does not apply to U.S. taxes under this article in the case of U.S. residents (who are not U.S. citizens), Chinese diplomats who are considered U.S. residents similarly will not be subject to U.S. tax on their diplomatic salaries.

Article 27. (Entry into force)

The countries are to notify each other in writing, through diplomatic channels, upon the completion of their respective legal procedures to bring the proposed treaty into force. The proposed treaty and proposed protocol will enter into force on the 30th day after the latter of the notifications.

These entry-into-force rules differ from those of the U.S. model treaty which require the countries to exchange instruments of ratification as soon as possible and provide for entry into force upon that exchange.

The proposed treaty and protocol will be effective for income derived in taxable years beginning on or after the January 1st next following the date on which the treaty and protocol enter into force.

IX. TEXT OF THE RESOLUTION OF RATIFICATION

Resolved (two-thirds of the Senators present concurring therein). That the Senate advise and consent to the ratification of the Agreement between the Government of the United States and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, together with a supplementary protocol and exchange of notes, signed at Beijing on April 30, 1984.

Sec. 152. Dependent defined.

(a) General definition.

For purposes of this subtitle, the term "dependent" means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) or (e) as received from the taxpayer):

(1) A son or daughter of the taxpayer, or a descendant of either,

(2) A stepson or stepdaughter of the taxpayer,

(3) A brother, sister, stepbrother, or stepsister of the taxpayer,

(4) The father or mother of the taxpayer, or an ancestor of either,

(5) A stepfather or stepmother of the taxpayer,

(6) A son or daughter of a brother or sister of the taxpayer,

(7) A brother or sister of the father or mother of the taxpayer.

(8) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer, or

(9) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to section 7703, of the taxpayer) who, for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household.

(b) Rules relating to general definition.

For purposes of this section –

(1) The terms "brother" and "sister" include a brother or sister by the halfblood.

(2) In determining whether any of the relationships specified in subsection (a) or paragraph (1) of this subsection exists, a legally adopted child of an individual (and a child who is a member of an individual's household, if placed with such individual by an authorized placement agency for legal adoption by such individual), or a foster child of an individual (if such child satisfies the requirements of subsection (a)(9) with respect to such individual), shall be treated as a child of such individual by blood.

(3) The term "dependent" does not include any individual who is not a citizen or national of the United States unless such individual is a resident of the United States or of a country contiguous to the United States. The preceding sentence shall not exclude from the definition of "dependent" any child of the taxpayer legally adopted by him, if, for the taxable year of the taxpayer, the child has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, and if the taxpayer is a citizen or national of the United States.

(4) A payment to a wife which is includable in the gross income of the wife under section 71 or 682 shall not be treated as a payment by her husband for the support of any dependent.

(5) An individual is not a member of the taxpayer's household if at any time during the taxable year of

the taxpayer the relationship between such individual and the taxpayer is in violation of local law.

* * *

THE REMAINING PORTIONS OF
THIS SECTION ARE NOT
RELEVANT TO THE
MATTER BEFORE
THIS COURT.